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Research UPDATE

from the Federal Reserve Bank of New York

RESEARCH AND MARKET ANALYSIS GROUP

Fed Conference Examines U.S. Education Reform

Economists and educators attending the Federal Reserve Bank of New York's conference "Excellence in Education: Views on Improving American Education" on November 14, 1997, explored a variety of strategies for strengthening the performance of the nation's primary and secondary schools. Conference participants agreed that one strategy—offering students a greater choice of schools—has led to demonstrably better educational outcomes for low-income urban minorities. Nevertheless, participants cautioned that the existing evidence is insufficient to justify expanding choice programs to the student population as a whole.

Participants called for further experimentation with education reforms and urged that new studies be carefully designed to permit a full evaluation of results.

The proceedings of the conference, published in a special issue of the Bank's ***Economic Policy Review*** (vol. 4, no. 1), cover four broad topics: the effectiveness of current school spending, the impact of school choice on student achievement, the relative performance of public and private schools, and the importance of educational standards. Speakers at the conference included many of the key figures in the current debate on education reform.

A starting point for much of the discussion was the perceived mismatch between the training provided by elementary and secondary schools and the increasingly sophisticated skills required by employers in today's labor market. As a number of conference participants noted, many students graduating from high school today cannot qualify for jobs that would enable them to secure a traditional middle-class living.

Although studies to date are not adequate to support large-scale reforms, the conference speakers presented evidence that more limited strategies can be effective. For poor urban students, the option to attend private schools can result in improved test scores and graduation rates. Some research findings suggest that schools would benefit from adopting more rigorous performance standards, such as detailed curriculum standards, regular assessments of student progress in mastering the curriculum, and stricter grading and grade-promotion policies. Conference participants also offered evidence that reducing class size results in improved performance on standardized tests, particularly for low-income students.

Another topic of discussion was the methodology of evaluation—how policymakers should assess the cost-effectiveness of specific reforms. Researchers have taken different approaches to putting a dollar value on educational improvements. Some examine the effect of such improvements on the wages earned by students later in life. An alternative method, developed in detail in one conference paper, involves calculating what people are willing to pay to reside in a community with superior schools.

Although the speakers at the conference expressed different views on the extent of the problems affecting American schools, they agreed that more studies are needed before policymakers proceed with ambitious reforms of the current system. For the immediate future, they recommended continued experimentation with different reform initiatives.

Publications and Papers

The Research and Market Analysis Group produces a wide range of publications and discussion papers:

- The ***Economic Policy Review***—a policy-oriented research journal focusing on macroeconomic, banking, and financial market topics. **www.ny.frb.org/rmaghome/econ_pol**
- ***Current Issues in Economics and Finance***—a newsletter-style publication offering concise analyses of economic and financial topics. **www.ny.frb.org/rmaghome/curr_iss**
- ***Second District Highlights***—a regional supplement to ***Current Issues*** covering financial and economic developments in the Federal Reserve System's Second District. **www.ny.frb.org/rmaghome/curr_iss/sec_dis**
- ***Staff Reports***—technical papers presenting research findings, designed to stimulate discussion and elicit comments. These papers are intended for publication in leading economic and finance journals. **www.ny.frb.org/rmaghome/staff_rp**
- ***Research Papers***—discussion papers reporting preliminary research findings. **www.ny.frb.org/rmaghome/rsch_pap**
- ***Publications & Other Research***—a brochure spotlighting the Group's research output for the year. **www.ny.frb.org/rmaghome/otherres**

New York–New Jersey Job Recovery Expected to Continue in 1998

The pattern of employment recovery in the New York–New Jersey region is expected to remain unbroken in 1998—despite a slight slowing in job growth—according to the Federal Reserve Bank of New York's regional jobs forecast (***Current Issues in Economics and Finance***, vol. 4, no. 3).

The forecast projects 1.3 percent job growth for the region, down slightly from the 1997 nine-year high of 1.7 percent. New jobs are also projected to slip, from 195,000 to 149,000. The deceleration is attributed almost wholly to the effects of an anticipated slowing of growth in the U.S. economy.

Within the region, job growth in New Jersey should reach 1.8 percent, down from 2.4 percent in 1997. Growth of 1.0 percent is forecast for New York State, slowing from 1.4 percent last year. New York City jobs are expected to expand by 1.2 percent, somewhat below the 1.6 percent growth rate achieved in the previous year.

Price Competitiveness of U.S. Exports Is Assessed

U.S. dollar movements had a profound effect on the price competitiveness of U.S. exports in the 1980s, but their impact has been much less dramatic during most of the 1990s, according to Thomas Klitgaard and James Orr in "Evaluating the Price Competitiveness of U.S. Exports" (***Current Issues in Economics and Finance***, vol. 4, no. 2).

If sustained, the dollar's recent rise will make it more difficult for U.S. firms to keep pace with their competitors.

The authors arrive at these findings first by using a trade-weighted U.S. dollar index to track the dollar's performance against that of key foreign currencies. The index, developed by the authors, measures how exchange rate movements or inflation conditions can affect U.S. price competitiveness. The authors then demonstrate the index's link to exports by comparing the growth rate of U.S. exports to specific foreign markets with the corresponding rates for Germany and Japan—the nation's main export competitors.

From this analysis, Klitgaard and Orr conclude that "the dollar's sharp run-up during the first half of the 1980s had a significant negative impact on U.S. foreign sales relative to those of Germany and Japan, while the dollar's fall in the latter half helped U.S. firms regain market share." They note that in the first half of the 1980s, the dollar's appreciation hit U.S. exports hard, while German and Japanese exporters enjoyed robust growth in virtually all markets examined. The dollar's sharp drop beginning in 1985 led to a boom in U.S. exports that was mostly unmatched by German and Japanese exports.

The authors observe that exchange rates and relative inflation rates have been much more stable in the 1990s. Despite this stability, overall U.S. export sales were still stronger than German or Japanese sales. The authors attribute the difference largely to the removal of North American trade barriers rather than a weak dollar.

Dollar movements could influence trade in the future, however. Klitgaard and Orr acknowledge that the dollar appreciation that began in 1997 has hurt U.S. price competitiveness and, if sustained, will continue to do so. To keep pace with foreign firms, the authors say, U.S. exporters would have to adopt cost-cutting methods and possibly accept lower profit margins. Nevertheless, the authors explain, although the dollar's current level is relatively high, the dollar index is not significantly out of the bounds in which it fluctuated earlier in the 1990s. "Further sharp increases in the dollar's strength would be necessary to push our index of price competitiveness to the high levels of the mid-1980s."

Many Workers Forgo Opportunity to Save for Retirement through 401(k) Plans

An increasing number of employers are sponsoring pension plans that enable workers to make their own investment decisions. These decisions include whether to participate, how much to contribute, how to invest the plan assets, and what to do with the plan assets upon switching jobs. Of such employee-directed plans, the 401(k) is the most common.

In "How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions" (***Staff Reports***, no. 38), William F. Bassett, Michael J. Fleming, and Anthony P. Rodrigues review the choices made by workers offered 401(k) plans. While retirement planning choices are increasingly becoming the responsibility of the individual, many workers—

Recently Published

Beverly Hirtle. "Derivatives, Portfolio Composition and Bank Holding Company Interest Rate Risk Exposure." ***Journal of Financial Services Research*** 12, no. 2-3: 243-66.

Sangkyun Park. "Effects of Price Competition in the Credit Card Industry." ***Economics Letters*** 57, no. 1: 79-85.

Asani Sarkar and Michelle Tozzi. "Electronic Trading on Futures Exchanges." ***Derivatives Quarterly*** 4, no. 3: 7-14. Adapted from Federal Reserve Bank of New York ***Current Issues in Economics and Finance*** 4, no. 1.

particularly low-income workers—are not participating in 401(k) plans or are participating in a limited way, the authors report.

The study, which draws on data from the 1993 Current Population Survey, finds that more than one-third of the workers who are offered 401(k) plans opt not to participate. Factors such as income, age, job tenure, education, and home ownership affect the decision to join. For example, while 81 percent of workers with family incomes of at least $75,000 choose to participate, only 36 percent of workers with family incomes of less than $15,000 choose to participate.

Many workers—particularly low-income workers—are not participating in 401(k) plans or are participating in a limited way.

Employer matching can also influence a worker's decision to join a 401(k). Workers whose employers offer matching contributions are more likely to participate in 401(k) plans than workers whose employers do not offer such matches. Surprisingly, participation does not appear to rise as the rate of employer matching increases.

After reviewing 401(k) participation decisions, Bassett, Fleming, and Rodrigues look at preretirement lump-sum distributions and rollover decisions. They find that nearly one-half of workers who had a pension plan in a previous job report taking a lump-sum distribution from the plan before retirement age. In recent years, only 28 percent of these distribution recipients have rolled over their investments into tax-qualified plans. Workers with high incomes, advanced education, and their own homes are more likely to roll over lump-sum distributions. The size of the distribution is also an important predictor—larger distributions are more frequently rolled over into tax-qualified plans.

Although 401(k) plans have grown rapidly in the past ten years, with annual contributions more than doubling during that period, Bassett, Fleming, and Rodrigues observe that low participation rates and the low rollover rate of preretirement distributions are troubling: "As our main data source does not measure household assets or saving, we cannot draw definitive conclusions about the overall adequacy of workers' retirement income. Nevertheless, our findings raise concern that many workers may not be adequately saving for their retirement years."

1997 Publications Brochure Available

Our 1997 ***Publications & Other Research*** brochure was released earlier this year. The twenty-four-page brochure highlights much of the work published by the Research Group over the past year—both in our four research series and in leading academic journals.

Copies are available by returning the enclosed order form or by visiting **www.ny.frb.org/rmaghome/otherres**.

New Officer Appointed in Charge of Statistics Area

The Research and Market Analysis Group welcomes the appointment of Leon W Taub as vice president of the Group's statistics area. Mr. Taub was formerly Chief of the National Income and Wealth Division of the U.S. Commerce Department's Bureau of Economic Analysis, where he oversaw the production of the U.S. GDP estimates and research on GDP data sources and components. He holds a Ph.D. in economics from New York University.

The statistics area collects financial and bank structure data for use in bank supervision and compliance monitoring. The data are also used in the implementation of monetary and foreign exchange policy, the construction of monetary aggregates, and the tracking of domestic and international capital markets.

From the Federal Reserve Bank of New York: A Revised and Expanded Guide to the Conduct of U.S. Monetary Policy

The 1998 edition of ***U.S. Monetary Policy and Financial Markets*** offers an updated account of the Federal Reserve's procedures for formulating and carrying out monetary policy. Author Ann-Marie Meulendyke explains the role of the Federal Open Market Committee in setting policy and details the steps taken by the Federal Reserve Bank of New York's Trading Desk to implement the Committee's decisions through open market operations. The book also explains how policy is transmitted to the nation's economy through the banking system and financial markets.

Included in the volume is a short history of monetary policymaking and the Federal Reserve System. A chapter on the international dimensions of monetary policy, substantially revised for this edition, explores how changes in domestic policy affect the economies of other countries and how developments abroad can influence the actions of U.S. policymakers.

Designed to supplement monetary economics textbooks, ***U.S. Monetary Policy and Financial Markets*** will be of particular interest to students and teachers of money and banking. In addition, the book should prove useful to all members of the academic, business, and financial communities who would like to know more about monetary policy and its effects on today's marketplace.

To obtain a copy of ***U.S. Monetary Policy and Financial Markets***, use the enclosed order form. The book is also available at www.ny.frb.org/pihome/addpub.

Capital Regulation Conference Held at New York Fed

In February, the Federal Reserve Bank of New York hosted "Financial Services at the Crossroads: Capital Regulation in the Twenty-First Century"—a conference cosponsored with the Bank of England, the Bank of Japan, and the Federal Reserve System's Board of Governors. Speakers included Federal Reserve Chairman Alan Greenspan; Tom de Swaan, Chairman of the Basle Committee on Banking Supervision and Executive Director of de Nederlandsche Bank; Thomas Labrecque, President of Chase Manhattan Corporation; and Edgar Meister, a member of the Board of Directors of the Deutsche Bundesbank.

One of the main concerns voiced during the sessions was that financial innovation and developments in risk management practices within financial institutions have put pressure on the current system of risk-based capital regulations. Several conference papers suggested that the effectiveness of supervisory rules and guidelines—especially regulatory capital requirements—will vary as the circumstances facing financial institutions change and as these institutions develop new and increasingly complex risk management methods.

Another key issue involved the limitations of the "one-size-fits-all" approach to capital regulation. Participants suggested that crafting effective one-size-fits-all regulatory capital requirements is extremely difficult because each financial institution's circumstances and characteristics influence how it responds to any rules. Participants concluded that the basic approach to supervisory capital requirements will continue to evolve over time, reflecting innovations in risk management and measurement at financial institutions as well as changes in the views and experience of supervisors concerning the prevailing capital regime.

A special issue of the Bank's ***Economic Policy Review*** devoted to the conference proceedings will be issued later this year. In the meantime, longer versions of many of the papers presented are available at our web site: www.ny.frb.org/rmaghome/conference.

Web Site News

- Members of the Federal Reserve Bank of New York's Research and Market Analysis Group can be reached via e-mail at **firstname.lastname@ny.frb.org**.
- Back issues of many of our publications and papers are available conveniently at our web site. There, you can also find links to other Federal Reserve System research offerings and to Federal Reserve Bank of New York information and announcements.
- Our Electronic Alert Service can automatically notify you by e-mail when new publications are available at our web site. You can then go directly to the site and download a publication or order the hard-copy version electronically. To subscribe to this free service, visit our site.
- You can now download papers presented at Federal Reserve Bank of New York conferences. For example, many papers from the recent conference "Financial Services at the Crossroads: Capital Regulation in the Twenty-First Century" are at our site.

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RESEARCH AND MARKET ANALYSIS GROUP PUBLICATIONS AND PAPERS: JANUARY–MARCH 1998

Economic Policy Review

Volume 4, Number 1 (March)

To Our Readers, *by William J. McDonough*

Creating a Performance-Driven System, *by Rudy Crew*

Conclusions and Controversies about the Effectiveness of School Resources, *by Eric A. Hanushek*

Reassessing the View That American Schools Are Broken, *by Alan B. Krueger*

What Do America's "Traditional" Forms of School Choice Teach Us about School Choice Reforms? *by Caroline M. Hoxby*

Schools and Student Achievement: More Evidence from the Milwaukee Parental Choice Program, *by Cecilia Elena Rouse*

What Have We Learned about the Benefits of Private Schooling? *by Derek Neal*

Measuring the Value of Better Schools, *by Sandra E. Black*

The Two-Legged Stool: The Neglected Role of Educational Standards in Improving America's Public Schools, *by Julian R. Betts*

Standards, Information, and the Demand for Student Achievement, *by Richard J. Murnane and Frank Levy*

Current Issues in Economics and Finance

Electronic Trading on Futures Exchanges, *by Asani Sarkar and Michelle Tozzi*
Volume 4, Number 1 (January)

Evaluating the Price Competitiveness of U.S. Exports, *by Thomas Klitgaard and James Orr*
Volume 4, Number 2 (February)

New York–New Jersey Job Recovery Expected to Continue in 1998, *by James Orr, Rae D. Rosen, and Mike De Mott*
Volume 4, Number 3 (March)
Second District Highlights

Staff Reports

Estimation of Cross-Country Differences in Industry Production Functions, *by James Harrigan*
Number 36 (January)

How Big Are Potential Welfare Gains from International Risksharing? *by Eric van Wincoop*
Number 37 (February)

How Workers Use 401(k) Plans: The Participation, Contribution, and Withdrawal Decisions, *by William F. Bassett, Michael J. Fleming, and Anthony P. Rodrigues*
Number 38 (March)

Research Papers

Asset Market Hangovers and Economic Growth: U.S. Housing Markets, *by Matthew Higgins and Carol Osler*
No. 9801 (January)

Methods for Evaluating Value-at-Risk Estimates, *by Jose Lopez*
No. 9802 (March)

Interbank Interest Rates as Term Structure Indicators, *by Allan M. Malz*
No. 9803 (March)

Modelling the Instability of Mortgage-Backed Prepayments, *by Stavros Peristiani*
No. 9804 (March)

Judging the Risk of Banks: What Makes Banks Opaque? *by Donald P. Morgan*
No. 9805 (March)